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DECENTRALIZATION IN INDONESIA: PROSPECTS AND PROBLEMS*

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The Government of Indonesia seems committed to a major program of governmental decentralization, and has recently passed two laws on various aspects of decentralization, Law No. 22/1999 on Regional Government (UU PD) and Law No. 25/1999 on the Fiscal Balance between the Central Government and the Regions (UU PKPD). If fully implemented, these laws promise to transform intergovernmental fiscal relations in Indonesia. Many would see decentralization as a long overdue structural reform in Indonesia, and many would also see decentralization as a necessary response to the political situation. However, many details of the program have not yet been worked out, and there is even some question about the overriding goals that the government wants to achieve with its decentralization policy.

In this report, we address five questions:

1. Indonesia in international perspective - does world practice suggest that Indonesia is a good candidate for fiscal decentralization?
2. What are the major features of the new decentralization laws?
3. What is the general process that is leading the reform program?
4. What are the specific problems related to the implementation of the reforms?
5. What can donors do to assist the Government of Indonesia?

Several supporting appendices are also attached.

Indonesia in International Perspective

In many respects, Indonesia's system of fiscal decentralization would seem to be make it an outlier. It has many of the characteristics of a country that typically chooses decentralization as an economic policy, but it has chosen to remain a centralized state. Empirical work on this subject - the determinants of fiscal decentralization - points to a number of characteristics of countries that have adopted decentralized political and fiscal structures.

Countries that have large populations and land areas tend to be more decentralized. It is too difficult and too costly to govern effectively from the center when the population and land area are very large. Large countries are likely to have large variation among regions in climate, geography, and economic base, so that centrally mandated uniformity in the provision of government services is likely to be quite inefficient. Moreover, there are diseconomies of scale in trying to govern large countries, which relate to the manpower costs of bureaucratic red tape, the time required to approve local decisions, and the problems of communications (e.g., Russia has 11 time zones).

For this reason, many of the world's largest countries have adopted decentralized forms of governance and finance (e.g., the U.S., Canada, Australia, Germany, Russia, Nigeria, India, Brazil, and Argentina). China has not formally decentralized, but it operates under a de facto decentralized fiscal system. In this regard, Indonesia seems to be an outlier, along with Egypt and a few other places. Based on its size and geography, one would predict Indonesia to be governed under a decentralized structure.

Countries that have diverse populations tend to be more decentralized. If the population of a country is diverse, or if the regional economies are diverse enough that there are distinct regional preferences for government services, then there is a strong case for decentralized governance. "Diversity" might mean a number of different things; examples of the kinds of diversity that typically lead to cries for decentralization are variations in ethnic, religious, and cultural backgrounds, isolation from the governing centers, and distinctive economic bases. Indonesia certainly is characterized by such diversity.

Diverse countries seem to decentralize for two reasons: to accommodate regional differences in preferences for services, and/or to hold a potentially divided country together by providing appeasement via some degree of regional autonomy to potential breakaway regions. Indonesia is an island nation with an economy dominated by Java and some degree of ethnic

diversity, and so would seem to fit both of these criteria.

Countries that have achieved a higher level of economic development tend to be more decentralized. Empirical evidence suggests that countries at a higher level of economic development tend to be more decentralized. There would seem to be four factors to consider here, in evaluating why economic development stimulates decentralization and in assessing how Indonesia might fit this pattern.

First, economic development and popular election seem to have gone hand in hand in the past two decades. As local officials are locally elected, and as national officials are elected and parliament becomes a separate political force from the office of the president or prime minister, the demand for local control over governance becomes all but irresistible. Indonesia is clearly moving in this direction, although the full "accountable downward" argument for fiscal decentralization is still a way off in Indonesia, as discussed in more detail below.

Second, more developed countries tend to have less exposed economies, are less susceptible to external influences, and are less susceptible to wide swings in prices, employment, and external balance. For these reasons, they may put less weight on centralizing the fisc in the name of maintaining flexibility to pursue stabilization policy. The opposite is true of less developed countries. Indonesia is beginning to rebound from a major economic disruption, and may be cautious about going too far with fiscal decentralization, especially in regards to giving local governments significant taxing and borrowing powers.

Third, industrialized economies tend to have their infrastructure more fully developed, and have more flexibility to leave capital investment decisions to local governments. They are also in a position to relax standards that might be imposed to insure that local governments provide services at proper levels. Indonesia's infrastructure needs remain considerable, and there are fears about a slowdown of government investment in priority areas if capital decisions are left to the subnational

governments.

Fourth, more developed countries tend to have more equal regional distributions of income and wealth, and less need to fear the inevitable counter-equalizing influences that come with fiscal decentralization. Indonesia, by contrast, is characterized by large inter-regional disparities in per capita income and infrastructure quality.

In sum, there are many features of Indonesia that argue for much greater decentralization than has occurred to date. The main feature of Indonesia that, in the experience of other countries, typically argues for greater centralization is civil unrest; that is, countries at war, close to war, or fearing internal military strife tend to be more centralized. This is an argument made by some for Indonesia's long history of governmental centralization. Turmoil in such provinces as Aceh, Irian Jaya, and East Timor has often been used to justify continued centralization of authority.

However, the Government of Indonesia has now embarked upon a program of fiscal decentralization. The next section outlines the major features of this program.

The Nature of the Indonesia Decentralization

Since the 1950s, Indonesia has been a highly centralized but multi-tier unitary state, with provinces and then local governments as the tiers under the central government.¹ Laws No. 22/1999 and 25/1999 propose to change this organization of governments, in several fundamental ways.

First, Law No. 22/1999 on Regional Government (UU PD) eliminates the hierarchical relationship between the provincial and the district governments. The district governments -

¹ For detailed discussions of intergovernmental issues in Indonesia prior to the enactment of the recent laws, see Anwar Shah and Zia Qureshi, *Intergovernmental Fiscal Relations in Indonesia*, World Bank Discussion Paper 239 (Washington, D.C.: The World Bank, 1994); and Robert H. Aten, "Why Increased Local Democratic Decisionmaking Would Aid Indonesian Economic Development", U.S.A.I.D. Working Paper (Jakarta: December 1997).

previously known as *kotamadya/kabupaten* and now called *kota/kabupaten* - will become fully autonomous, so that the heads of these district governments (the *walikota/bupati*) will no longer report to the governor of the province. Instead, the district heads will be responsible to the locally elected assembly (*Dewan Perwakilan Rakyat Daerah, or DPRD*). In contrast, the provinces will retain a hierarchical relationship with the central government.

Second, with some limited exceptions, Law No. 22/1999 also makes all deconcentrated central government ministries at the province and the district the responsibility of the respective local government.² (The exceptions are for defense and security, foreign policies, monetary and fiscal policies, judiciary affairs, and religious affairs.) This change promises a major reorganization in the way in which public services will be delivered in Indonesia.

Third, Law No. 25/1999 on the Fiscal Balance between the Central Government and the Regions (UU PKPD) alters the transfers received by local governments from the central government. The current routine transfer that is largely used to pay the salaries of local civil servants (the *Subsidy Daerah Otonom, or SDO*) will be eliminated; also eliminated will be general development transfers known as block *Instruksi Presiden*, or block *Inpres*. These two transfers are

² In the current system, the central government and its ministries have "deconcentrated" departments called a *kepala kantor wilayah, or kanwil*, at the provincial level; in some cases, the *kanwil* has a sub-branch at the district (or subdistrict) level called a *kantor departemen, or kandep*. The province has its own planning agency (*Bappeda*) and various autonomous "decentralized" departments (or *dinas*) under its own control at the provincial level, generally consisting of departments for own revenues (called a *dinas pendapatan daerah, or dipenda*), as well as *dinas* for education and culture, health, public works, traffic management, agriculture, livestock, fishery, forestry, plantations, industry, social welfare, labor, and tourism, all of which have central government counterparts in the deconcentrated *kanwils*; the province may also have branch offices (called *cabang dinas*) at the district level, although this is apparently not that common. Like provinces, districts have an autonomous "decentralized" department in charge of own revenues (again, called a *dipenda*), and they generally have departments (or *dinas*) for services like health and public works, although the range of these departments depends upon size and location of the district. In the new system, the deconcentrated central government departments at the provincial level will become the responsibility of the province, and those at the district level will be turned over to the district.

instead combined into a general allocation fund whose total amount is specified as 25 percent of central government domestic revenues and whose distribution among local governments will be determined by formula. Law No. 25/1999 also introduces revenue sharing for provincial and district governments, assigning each level of government its share of revenues from taxes on land and buildings, the transfer of land and buildings, forestry, mining, fisheries, oil, and gas. Other local government sources of revenues (e.g., own source revenues, fees and charges, profits from government enterprises, borrowing) are unchanged, as are revenues from specific *Inpres* grants used to finance development projects in areas like primary schools, health facilities, water supply, and roads.³

When - and if - fully implemented, the two decentralization laws will transform intergovernmental relations in Indonesia. In particular, and together with the recent elections that have been held at the province and district levels, the laws have the potential to increase significantly the accountability of local government officials. It is through this accountability that the major advantage of decentralization is obtained: moving government closer to the people. The leaders of the local governments - the governor at the provincial level, the bupati at the kabupaten, and the mayor at the kota - will now be chosen by the respective elected council (although not directly by the voters), rather than appointed from above, so that their responsibility will be directed downward to the elected council and not upward to the central government. The assignment of significant new expenditure responsibilities to provincial and, especially, to *kota/kabupaten* governments has the potential to achieve the efficiency gains that come when governmental decisions are more responsive to the wishes of its citizens, so that public services are provided in amounts that correspond more closely to the preferences of the individuals in those jurisdictions,

³ Provincial taxes consist of a tax on motor vehicles, on the transfer of motor vehicles, and on motor vehicle fuel. District taxes include the hotel and restaurant tax, the entertainment tax, the advertising tax, the street lighting tax, the mineral tax, and the water use tax.

rather than at uniform national levels. Other potential gains include greater revenue mobilization because citizens may be more willing to pay local taxes to provide local public services and because local governments may be more familiar with, and so better able to tax, local tax bases.

However, it is important to note that the two laws provide mainly for expenditure, but not revenue, decentralization. Despite the enactment of revenue sharing for natural resource revenues, the laws do not give local governments any new, meaningful, and locally controlled tax instruments. This is a major limitation of the new laws. In order to establish a link between costs incurred and services demanded by citizens, local governments must have the ability to make some real choices in their use of tax instruments (at least at the margin). It is this linkage that is crucial: it makes the citizens aware that there is a connection between the taxes that they pay and the services that they receive (at least if there is transparency), and it establishes accountability on the part of the local government officials. This does not require that the government control **all** of its revenues, only **enough** to change on the margin the revenues it collects and so the services it provides. However, even this modest amount of local control is not present in the decentralization reforms.

It is also important to note that the two laws are not accompanied by any well-articulated goals that their implementation is intended to achieve; indeed, the entire process by which the decentralization has proceeded seems ill-defined. The laws also lack any specific details that their implementation will require. These aspects of the decentralization are a significant limitation of the new laws, for reasons discussed in detail in the next sections.

The Process and Goals of Decentralization

The Government of Indonesia has taken a politically expedient path in the development of its decentralization policy. The first step in most successful decentralizations is the development of a general framework within which the broad goals of the reforms are articulated and agreed upon, in

something that might be embodied in a government "white paper". This step seems to have been completely skipped in Indonesia. Instead, the Government has moved directly to drafting decentralization laws, and it is now beginning to think about drafting the implementing regulations that go with these laws. At present, there seems to be little intention to go back to the question of policy design.

One must be sympathetic with the strategy of "getting on with it", and indeed it seems unlikely - and undesirable - that a process already underway will be stopped in its tracks. However, this kind of shortcut raises several questions. Is the Government clear on what it wants to achieve with the decentralization? Is there widespread support within the Government for these objectives? Is the decentralization strategy that is moving forward a well thought-out plan, or is it more of an idea in its infancy with many unanswered questions about its structure?

As noted, the first step in successful decentralizations is a clear statement of the objectives of the reforms. However, we could not find any such statement. From interviews with various government officials, we learned that the current policy has been under discussion for two decades, mainly in the Ministry of Home Affairs, with an original policy paper apparently written in the 1970s. However, officials also reported that the policy paper was not widely disseminated. Also, there has been little advance preparation for the decentralization. It is the case that a pilot program (the "District Autonomy Pilot Program", or DAPP) was established in 1994/1995, in which a number of local governments were given more responsibilities. As part of this program, there has been some effort to evaluate the ability of local government officials to handle these responsibilities, with the general conclusion that local governments are largely unprepared for any new tasks. Further, we can identify only one common issue that is being addressed by the decentralization program: the need to move government decision making on taxes and expenditures to the provincial and the district level. It is not yet clear that this means "closer to voters", and it is also not yet clear that

central government ministries will resist the effort to impose regulations, mandates, and minimum standards on local government service delivery, all of which would reduce local autonomy. It is certainly clear that the reforms do not extend any new significant revenue raising powers to the local governments.

A "plan" is not simply an afterthought, but is a necessary starting point for any successful reform. There is no single best structure for fiscal decentralization. There are many versions, and the appropriate strategy for a country depends on what the country is trying to accomplish. When there is not a clearly articulated decentralization policy, and one that commands widespread support and consensus, then there is no road map for designing all features of the program - the laws, the regulations, the transition, the implementation, or the evaluation. Such would seem to be the case in Indonesia.

Consider the following issues:

- The laws defining expenditure assignment and revenue powers are being written in an uncoordinated way by two different groups within government. Without a policy design to guide this drafting, it is almost guaranteed that there will be a fiscal mismatch, setting the stage for a "soft budget constraint" for local governments.
- The design of intergovernmental transfers is not being guided by clearly stated government objectives concerning equalization, the desired level of expenditure control by line ministries, local government revenue mobilization, and the like.
- Without a clearly stated set of objectives and priorities for the decentralization program, it will be difficult to draft the implementing regulations for the various components of the program. Nearly all of these implementing regulations have yet to be written, let alone issued.
- Similarly, the absence of a clear statement of objectives and priorities will make it impossible to evaluate the success for the various components of the program or to put in place an evaluation effort.
- Indonesia's decentralization program will grow and develop as the country changes in the coming years, and a strategy for adjusting the structure of the decentralization policy to keep up with this economic development will be essential. This fine tuning must be guided by a clearly articulated set of objectives and priorities.

Piecemeal reforms often achieve some goals, but they are also plagued by many problems.

Issues in the Implementation of the Reforms

To take the next steps in a fiscal decentralization program, the Government of Indonesia will need to address a number of important issues. The subsections below outline these issues, and provide some anecdotal supporting evidence.

Revenue-Expenditure Balance. There may well be a mismatch between the revenues that are assigned to local governments and the expenditure responsibilities that are assigned to them. On the revenue side, the idea is to guarantee a transfer to local governments of 25 percent of domestic revenues, plus a share of natural resource revenues, in the form of intergovernmental transfers. On the expenditure side, the goal seems to be the decentralization of responsibility for a broad range of expenditure functions. We could find no evidence of any analysis of the expenditure budget for subnational governments implied by this assignment of functions, and no analysis of the adequacy of the 25 percent revenue transfer.

For example, in 1999/2000 the 25 percent allocation is projected to equal Rp. 35.6 trillion, or 25 percent of Rp. 142.2 trillion, which is roughly double projected regional routine expenditures of Rp. 19.5 trillion; also, revenue sharing is estimated at about Rp. 6-7 trillion, so that total local government transfers (aside from the specific allocations) are estimated at approximately Rp. 43 trillion. However, it is not known whether this amount is greater, equal to, or less than the target level of expenditures, either at the aggregate or at the disaggregate level.

In addition, there is much uncertainty about the revenue-expenditure balance at the local government level. Some local officials whom we interviewed believe that there will be no problem in paying the salaries of any new civil servants, in part because they mistakenly believe that the *SDO*

will continue, but there could be a problem in funding other routine expenditures because some new departments will be created that do not currently exist and funds must be found for these departments, especially for maintenance, transportation, utilities, electricity, papers, water, phones, and the like. Some district officials also believe that their revenues will be lower under the new system. Others, at both the province and the district levels, estimate that revenues will increase substantially with the turnover of the deconcentrated central government agencies and their budgets. For example, in North Sulawesi revenues and expenditures are Rp. 155.1 billion in the 1999/2000, and officials estimate that revenues will increase to Rp. 1,413.9 billion in 2000/2001, given their estimates of their share of the general allocation fund, of specific grants, of revenue sharing, and of salaries and development budgets of deconcentrated agencies. Of course, there will also be greater expenditure responsibilities, and the department estimates that expenditures will increase from Rp. 155.1 billion in 1999/2000 to Rp. 1,119.1 billion in the next year. On balance, then, the estimates are that revenues will exceed expenditures by Rp. 294.8 billion. Regardless, however, the local officials always indicated that they simply do not know what will happen to their budgets in the new system, in large part because they have no knowledge of the formulae for grant distribution. Similar uncertainty is present among central government officials. One estimate from the national planning agency *Bappenas* suggests that only 10 percent of the districts will have enough funds to be self-sufficient, but this is mainly a guess.

Local Government Capacity to Deliver Services. A major issue is whether the provincial and local governments can absorb these new expenditure responsibilities. The broad issue here is whether provincial and district governments can absorb the "back office" functions that are now centralized, including personnel management, data processing, procurement, contracting, and the like, and thereby provide the full range of services that will become their responsibility in the new system.

One view often expressed by local officials is that they will have little difficulty in providing these services, in part because many of these functions have already been largely shifted to local governments. In North Sulawesi, for example, 20 programs funded by specific *Inpres* allocations have been channeled directly to district governments by the provincial *Bappeda* since 1994, including programs for road, health, drinking water, primary schools, agriculture, and marketplace development. Other officials similarly claim that "it is easy to turn over an agency to a district". However, another expressed view is that the funds necessary to provide these support services may not be forthcoming, even if the local skills needed to provide the services are present. For example, the district of Minahasa participated in the District Autonomy Pilot Program (DAPP), during which the transfer of 9 (deconcentrated) departments with 500 employees to the district occurred (manpower, manufacturing, trade, social, cooperatives, mining, health, rural development, and registration). According to officials there, the results of the pilot were threefold: there was no problem in absorbing the employees, there was no problem in providing most of the basic services of the departments, but there were financial problems because only funds for routine expenditures (salaries) were transferred to the district and no funds for development expenditures were transferred. The Secretary believes that this last problem could also arise in the decentralization, if sufficient funds (aside from salary support) are not provided; if salary support is also not provided - and there are very mixed views on the likelihood of this - then additional problems will be created. A related concern often expressed is that magnitude of these tasks will be much greater in the new system, so that complete absorption will take some time and will vary greatly by local government. For example, one local government Secretary estimated that the extra burden of these functions could be as much as Rp. 15 billion relative to a district budget of Rp. 111.0 billion; another local Secretary estimated that the district civil service would roughly double in size with the reforms, from 12,000 employees to 24,000 employees; and in another district, the personnel officers said that the number

of district *dinas* would increase from 11 to 21 (adding new ones in fishing, livestock, mining, forestry, land institutes, industry, manpower, education and culture, cooperatives, and trade), with more than a doubling of district civil servants. In the province of North Sulawesi, there are currently 35,000 employees in deconcentrated agencies throughout the province (relative to 45,800 provincial civil servants), and, with decentralization, most of the 35,000 employees in the deconcentrated agencies would become provincial or district civil servants. Also, officials in professional and highly specialized deconcentrated agencies (e.g., education, manpower) worry that they often get extensive central government assistance on matters for which the local governments have little expertise or interest.

Overall, some officials estimate that only 10 to 20 percent of the districts can absorb all of their new duties quickly. A *Bappenas* rating indicates that only 3 of the 27 provinces meet appropriate standards at present, especially in the quality of the civil service. Some local government officials are already preparing for the changes. For example, in North Sulawesi, civil servants have been encouraged to improve their educational levels. Currently, there are roughly 100 people in *Bappeda*; 60 percent have the equivalent of a B.A. or B.S. (or 4-year college) degree, 13 have an M.A./M.S. degree, and another 15 are working on an M.A./M.S. However, this appears to be the exception. Instead, most local government officials are waiting for central government assistance here.

This general issue raises a number of specific questions:

- Is the quality of the human capital in the provincial and district governments up to the task of delivering the services to be transferred, or is the idea simply to absorb the heretofore central employees?
- How will management be handled? Will former central employees be brought into the provincial and local service, directly under local government managers? Will the managerial personnel from the central government be transferred in?
- Are there some purely physical limits to the absorption of these functions by subnational governments? For example, is the provincial and local computer system up to the

- increased record keeping tasks implied? What new budget formats and accountability systems will be required when these new functions are absorbed into the decentralized system? What provisions have been made, or need to be made?
- Will a new legal framework and a new reporting system need to be established to govern the budget decisions, personnel management, and the like of subnational governments? Will these governments be able to deal with the compliance costs involved?

These questions need to be answered.

Civil Service Issues. The civil service implications could be daunting, and it is not clear how far the planning has gone on this set of issues. Issues of seniority, compensation, pensions, fringe benefits, and work rules were raised consistently by central government employees who anticipate being absorbed into the subnational government service. More than anything else, civil servants are concerned about these issues.

Our discussions indicated that most central government civil servants prefer to stay at the center, rather than be transferred to the province or the district. However, the decentralization will eventually require massive transfers to local governments, according to one estimate, of perhaps as many as one-third of the 1.5 million central government civil servants.

Civil servants at all levels are largely in the dark, something that has created much anxiety for them. Surprisingly, some (though clearly not all) officials are unconcerned about salaries, believing that the central government will continue to pay their salaries via the *SDO*. Officials more often expressed anxiety about guarantees (or lack thereof) for certain positions, especially supervisory ones in departments that will be created or moved to district control. They noted that job rankings could be an issue. For example, one district Secretary has a current ranking of 2B; under the new system, he believes that his position will require a higher ranking of 1B (the same as a provincial-level Secretary), so he may not actually be "qualified" for his position in the new system. More generally, with new required rankings, there may not be sufficient numbers of qualified civil

servants for the various positions. Central government civil servants in deconcentrated agencies are also worried about career advancement in local governments, especially since they typically view themselves as "specialists" whose skills may not be appreciated or understood in a local civil service; indeed, a district counterpart agency does not always exist for the deconcentrated agencies, so that regulations need to be written. Issues like seniority (e.g., who will be the head of a deconcentrated department merged with a district counterpart agency), promotion, and transfer in the new system are very hazy at present; these will be determined by the district (not the central) government personnel people and their evaluations, and, again, the district may not apply the same standards as currently.

In the face of these issues, some officials believe that central and local government employees will be placed on the same track in a new system in order to maintain the "unity" of the civil service, as well as to allow the mobility of civil servants across provinces and districts; in their view, a unified system will require that the salaries continue to be paid by the central government. However, officials admit that this is largely speculation at this point, and they are awaiting the issuance of regulations.

Accountability of Elected Local Officials. There is a widespread belief that local accountability will be improved by the electoral process. Voters will now have some say in the determination of the composition of the local councils, and local officials often claimed that "expectations are high". The new procedures for the selection of the local head should also improve accountability. Under the old system, the local head was selected with the heavy involvement of the central government, so that the responsibility of the local head was directed mainly upward, to the central government. In contrast, under the new system the responsibility of the local head is downward, to the elected council that will elect the head without approval of the central government. Finally, there will be local approval of budgets, and this leads to increased accountability. Many

facets of the reform therefore move government closer to the people.

However, there are also some gray areas, where the new reform may not lead to as much accountability to voters. There is no proposal for significant expansion of local revenue raising powers, a point raised by several local officials as a limitation on local autonomy. Central government ministries may well impose a range of regulations, mandates, and minimum standards on the deconcentrated agencies, features that could severely limit local autonomy and therefore local accountability to voters. Intergovernmental transfers may well be conditional, which will limit local government discretion. The electoral process is not direct; that is, the responsibility of the elected official remains directly to the party rather than to the voters, and the party can select - and remove - candidates on its authority. Finally, it may take some time before the accountability implied by free elections actually occurs.

In fact, local officials have mixed views on the changes in accountability. Many believe that the new laws significantly increase their autonomy, and so their accountability. They point especially to local approval of budgets and local discretion on spending levels and composition. Central government officials generally endorse this view also, fearing that the central government may well lose overall budgetary control but that this is the price of decentralization.

However, many also believe that they already have substantial autonomy in the current system. In particular, the current formulation of the provincial development budget is a bottom-up procedure over which local officials exert substantial influence, and local officials do not believe that the decentralization will enhance (or lessen) this autonomy; the main change with the new laws is that final approval for the budget will come from the provincial assembly, rather than from the central government. On balance, these officials believe that they will have "more room to maneuver" and "less intervention from above", but that these changes will be minor.

Finally, there are some officials who believe that local autonomy will be largely unaffected by

the new laws. There is a strong possibility that central government ministries will resist the transfer of their line ministries to provincial and district governments via regulations and mandates, tendencies that are already apparent, because the ministries will lose much influence, resources, salaries, and the like with any transfer. These local officials also maintain that local autonomy will suffer from a lack of own local revenues; in the words of one district Secretary, there will be "decentralization in management" but there will be "no decentralization in finance".

Central Government Assistance and Leadership. Somewhat paradoxically, successful fiscal decentralization requires a strong central government to lead the process. Given that the Indonesian system will have over 300 provincial and district local governments, an important issue is whether the central government has the ability to provide the oversight, guidance, and leadership necessary.

There are a number of areas where such central leadership is crucial.

First, it is necessary for the central government to carry out analytical fiscal work to evaluate and to monitor the system on a continuous basis. This involves identifying tax effort performance, tracking local budgets, evaluating any proposed alternative fiscal reforms, and so on.

Second, the central government must maintain the intergovernmental transfer system. This will involve a number of activities, like updating the basic formula information and evaluating the equalization features of the grant system. In addition, if there are conditional grants, there needs to be a compliance monitoring system in place.

Third, and related to the the transfer system, one possibility is that the Indonesian government could create a finance commission to oversee and advise intergovernmental fiscal relations. This body would necessarily have to possess a strong analytic capability, some modeling capabilities, and an ability to make the system transparent. A finance commission could stand between the central and local governments, thereby becoming the honest broker of

intergovernmental fiscal relations. It could also resolve disputes between ministries in terms of fund allocations, thereby de-politicizing intergovernmental fiscal decisions. The central government will play a major role in organizing and supporting this unit.

Fourth, with the ability of provincial and district governments to borrow (with the approval of the central government), the central government will need to develop a regulatory framework that can monitor the compliance that goes with this (e.g., disclosure, purpose of borrowing, eligibility, limits).

Fifth, the central government will need a fiscal information system to monitor the progress of decentralization and to serve as the database for research necessary to continue to fine-tune the system. Many large countries with significant intergovernmental fiscal programs have moved to develop a fiscal information system (e.g., Brazil, India, U.S., Canada, Australia). It is our understanding that a management information system along these lines is currently being designed in the Ministry of Finance.

Sixth, the central government, if it imposes the condition of a hard budget constraint on subnational governments, will be charged with determining whether local governments are in compliance. Central governments also must lay down the rules for audit.

Seventh, to the extent the central government imposes regulations, mandates, and minimum standards (and it almost certainly will because all countries in the world do this), there must be a system to monitor compliance with these requirements. Examples include everything from compensation rates for employees, to environmental regulations, to the adherence with standards for school teachers, to the expenditure of minimum amounts.

Eighth, the central government may take the leadership in providing technical assistance and training to local governments. The more technical the training, the more likely is the central government to lead the training and technical assistance.

Ninth, in any intergovernmental fiscal system there will be disputes between the central and local government, among local governments, and even between ministries. Among the possible sources of contention are the specific data used in the formula distribution, compliance with grant conditionality, unclear expenditure assignments, and the like. The resolution of such disputes will require central government involvement. Again, a finance commission can assist in this task.

Tenth, if the central government adopts options such as a financial control board to deal with bankruptcy, or if the government intercepts to act as collateral for local borrowing, central control and monitoring will be required, as will sanctions and remedies for defaulting local governments.

All of these considerations point to the necessity that fiscal decentralization calls for a strengthening of the central government's ability to lead and manage the process. A necessary condition for successful decentralization is to have a strong central government intergovernmental fiscal relations unit in place. This in turn raises some important questions: where in government will such a unit be placed, how will its information system be supported, and how will it be staffed?

Revenue-raising Powers for Local Governments. No provisions have been made for local governments to raise significant own-source revenues. This means that there is presently no plan to devolve significant new taxing sources to local governments. If this is not done, there will not be full accountability of elected officials (or ruling parties) to the voter-taxpayers. If all expenditures are financed by intergovernmental transfers, the voters will not feel the pain associated with better services, as they would if the local government had some rate setting powers.

Local governments have some but limited autonomy on the determination of rates and bases. No new taxes for local governments are currently under consideration at the central government. Many local officials stated that they would like to take complete control of the land and buildings tax, something that apparently was considered by the central government at one point before being abandoned. Local governments can propose new taxes under some circumstances,

with approval necessary at the central government, and local officials are exploring these possibilities. For example, the district of Bitung has a major port, and possible new taxes include district fees on the entry and exit of ships, on handling of cement, and on handling of asphalt.

A Hard Budget Constraint for Local Governments. It is not clear that provision has been made for the imposition of a hard budget constraint on subnational governments. Two conditions are necessary. First, there must be a reasonable balance between expenditure responsibilities assigned and revenue instruments available. Second, the local government must have some access to tax rate setting so that they can tax their constituents to cover any shortfall. As of now, the balance between expenditure assignment and revenues has not been worked out, and, as noted above, there is no provision for significant local taxing power.

Another issue here is local government borrowing. Currently, provincial and district governments can borrow for capital projects, with central government approval, and these loans often come from regional banks. These banks are largely conduits for money from the center, are run by local bureaucrats for the benefit of the local government, and have just been recapitalized. Given these considerations, there is a real concern at the central government that local borrowing will grow out of control, despite the approval necessary for any such borrowing as specified in the two decentralization laws. In fact, some local officials stated that they believed that local loans would be assumed by the central government in the event that the local government was unable to service the loan, something that is undoubtedly mistaken but, if widely held, something that would also eliminate a hard budget constraint at the local level by creating a severe "moral hazard" problem for local officials.

The Laws and their Implementing Regulations. At the time of this writing, the new laws are stated in very general terms, and the implementing regulations have not yet been written. There also seems to be some ambiguity about who will write the implementation regulations. In a real

sense, the implementing regulations will define the structure of decentralization in Indonesia. The following are some of the more important issues to be specified in these implementing regulations:

- the exact assignment of expenditure responsibility, especially at the provincial level
- local tax authority
- local user charge authority
- borrowing powers
- civil service regulations
- the structure of the grants system.

Local officials do not seem overly concerned about the absence of these regulations at this stage of the decentralization. However, a constant refrain was that they simply did not know what would happen in virtually all areas of the reforms.

A Transition Plan. A fiscal decentralization program in a country so important as Indonesia needs a carefully thought-out transition plan. A major issue is the speed with which a decentralization program can be implemented, even if the plan is carefully thought out to cover all of the issues described above. By some estimates, at most 20 percent of all local governments are ready to absorb their significant new responsibilities. Even if these governments can assume the responsibilities presently laid out, there are concerns about the treatment of the remaining 80 percent of the governments. Will they be brought slowly into the system, with more limited powers until they prove their ability to take on the new responsibilities? What will be the criteria for graduation to the next class of municipality? What training will their civil servants be provided to assist them in their new responsibilities? These questions must be answered in a transition plan.

Donor Assistance in the Decentralization

Donors can take a range of actions to help in the reforms.

1. Facilitate the White Paper Process

The external donors and their advisors have the international experience and the available manpower to assist the Government of Indonesia in developing a policy strategy for its decentralization policy. As emphasized above, the development of a strategy and of an agreed-upon set of objectives is crucial. Until this is in place, the program cannot move successfully ahead with a consistent set of laws and implementing regulations.

The following is a stylized list of some activities that the donors could pursue to assist the development of the fiscal decentralization policy:

- Provide technical assistance to develop the necessary policy issue papers for discussion and debate. These issue papers are a necessary condition for moving ahead to a final design of the strategy and a final draft of the implementing regulations. The problems and issues described above are a partial menu of the issue papers that might be developed.
- Provide general advisory help. The Government and its internal consultants will be developing the details of the program, and the issue papers they produce should be reviewed by outside experts. Outsiders can also bring in international experience, and can assist with some of the analytic work. Decentralization is a politically charged issue, and many government officials will not want to take on some of the most crucial issues. However, the donors can provide experts who can lay out and evaluate even politically unpopular options, so that all sides can be heard in the debate.
- Assist in donor coordination. The external agencies should undertake coordination of donors who are working in this area. U.S.A.I.D., the World Bank, the International Monetary Fund (IMF), the Asian Development Bank, the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), the IDRC, and some other bi-laterals are providing financial assistance and financial support to decentralization efforts in Indonesia. However, there is considerable overlap in this work and possibly some confusion about the kinds of assistance that should be provided. A donor group should be created, but it should take on a technical role, including a technical review of each other's papers, the sharing of data and information, and the provision of inter-agency technical seminars.
- Organize a conference. The external donors should organize an off-shore conference for the major players in the decentralization program. It is necessary to focus the key decision makers on the major issues to be decided, and to give them a flavor of the tradeoffs involved and the experiences elsewhere. One way to do this is to hold, say, a

two-day meeting away from Indonesia, where a highly structured program is put in place. The program needs to be intensive, and it needs to focus on the key issues in Indonesia, but it also needs to spend more time on the concepts than on the Indonesia-specific situation. The leaders will have plenty of time for the latter, but will not likely get exposure to the international practice. This is the chance both to get some structure into the thinking and to move the debate back one step from being purely political.

- Provide training. A serious training program needs to be organized for those managers who will structure the program in accordance with the general policy of decentralization. Examples of the issues to be addressed include designing the grant system, identifying and structuring local revenue sources, forecasting the budget, establishing borrowing authority and limits, assigning expenditure and tax responsibilities, establishing expenditure mandates, and setting user charges. Training could be handled in two ways: in-country seminars on specific topics, and intensive foreign training courses. Unless managers and analysts are thinking about decentralization with a proper background of what works - and does not work - elsewhere, the process will be slowed. This is an important investment that the external donors might make.
- Provide technical assistance. The external donors could provide senior staff for the Government to assist in the drafting of the white paper, or at least to carry out the background analysis and prepare the background papers.

2. Basic Research on the "Numbers" and the Plan

Much basic quantitative research must be carried out before there is a decentralization plan ready for implementation. Of course, there is no substitute for the government doing this work, but the external donors could speed things up if they provided some background analysis. Some of the work may already have been done, some may have been partially done, and some may not have been done correctly. There are at least four areas where this work might be focused:

- Revenue/expenditure Balance. The plans for the decentralization of revenues via the intergovernmental transfer system, the proposed assignment of expenditures, and the proposals for local taxation and user charge autonomy need to be coordinated. It is necessary to estimate the cost implications of the expenditure assignment under consideration, and to cost out the central mandates that will likely be imposed. Following these calculations, the revenue needs can be estimated, and the feasibility of the 25 percent transfer of domestic revenues and the likelihood of a hard budget constraint can be considered. To do this work, a simulation model needs to be developed and estimated. From this, the Indonesian government could begin the hard work of making choices as regards the proper "vertical split" between different levels of government.
- Intergovernmental Transfers. Before the government can make decisions about the proper "horizontal split" of revenues among local governments, it must have hard data

on the budgetary implications of different formulae for the distribution among local governments. At present, there are analyses underway or completed by GTZ and by the IMF, and clearly the World Bank and U.S.A.I.D. need to be involved in order to complete their technical assistance programs. There needs to be a common core of hard data, and perhaps a common model that can be used by all. Armed with such a quantitative analysis, the Government can then begin making its decisions about the proper structure of the intergovernmental transfer system.

- Equalization versus Revenue Mobilization. The government ultimately needs to decide how much it wants to emphasize revenue mobilization and how much it wants to emphasize equalization. There are many pieces to this puzzle: the grant formula, conditionality, borrowing versus grants, expenditure assignment, mandates, local taxing and user charge powers, etc. A thorough quantitative analysis of the options and of their implications needs to be carried out.
- Evaluation. A major flaw in decentralization programs around the world is that there is little analysis of the degree to which the existing program is meeting the objectives set for it. Does the program equalize across local governments? Does it stimulate revenue mobilization? Does it lead to different public expenditure mixes? Are hard budget constraints effective? Do higher income places borrow more? Are budgeting practices improved? External donors could set up a modeling and information system that could be the basis for a rigorous quantitative evaluation system.

3. Bottom-up Issues Associated with the Transition

There are many implementation issues associated with the transition to a decentralized system in a country as large and as complicated as Indonesia. At present, there does not seem to be a detailed implementation plan. On the one hand, it seems clear that all local governments in Indonesia are not able to absorb their new responsibilities because of their very different management capabilities. On the other hand, it is quite easy to hide behind this issue and create a self-fulfilling prophesy that leads to the conclusion that "local governments are not able to manage their own affairs". The right answer is probably that there needs to be a transition in which the following things happen:

- Some local governments participate fully in the decentralization under the new system.
- Some local governments are classified as not yet ready for decentralized authority, but a clear set of criteria for promotion to full status is specified in detail.

The external donors could help this process. Working with Indonesian counterparts, they could organize a series of case studies to determine exactly what would be necessary to implement a decentralization program (e.g., budgets, management, civil service, absorption of new employees, back office function arrangements, training needs, etc.). This could be the criteria for selecting those who would go first into the program, and could also provide the criteria for deciding when a local government would be qualified to move to the next step.

Some parts of this work are already done (via U.S.A.I.D. budgeting case studies, for example), but other parts are not. A series of perhaps ten case studies of local governments, pointed exactly at what needs to be done in these jurisdictions to develop an implementation program, would be quite valuable. The final output would a detailed checklist of exactly what would be necessary and exactly how the government would evaluate this. This would not be the plan for implementation, but it could be very close.

4. Advice on Drafting the Implementing Regulations

The government is now in process of beginning to draft the implementing regulations, which will spell out the details that will allow interpretation of the law. This step will be crucial. It includes such things as exact expenditure assignments, revenue powers and limits, budget constraints, mandates, borrowing authority, and the like. External agencies could help in many ways. Examples could include the following:

- Technical assistance in developing a regulatory framework for debt issuance.
- Technical assistance in developing budget manuals covering everything from developing a uniform system of accounts, to an information system, to the preparation, execution, and evaluation of budgets. (Note that this may already be well along under U.S.A.I.D. technical assistance.)
- Technical assistance in developing appropriate training institutes to continue supporting the development of local governments. There are many ways this can be done, and

international experience is especially important in this regard.

5. Assistance in Developing a Transition Plan

An urgent need of the government is to develop a transition plan for decentralization. A major stumbling block to successful decentralization in most developing and transition countries is the implementation. Sometimes all the pieces are not in place, sometimes the speed of implementation is too fast or too slow, and very often the central government has no good ability to monitor or evaluate the process.

The external agencies could supply much needed help here:

- Some hand holding, based on international experience
- An outline of the steps necessary to carry off an implementation plan, based on the technical assistance in the areas described above
- Some consciousness-raising, resulting from the offshore and short-term training conferences outlined above, since it is essential that the political and the technical champions of decentralization have a firm grasp of the issues, choices, and implementation strategies available, as well as the pitfalls associated with each.

6. Create a Capacity for the Future

Decentralization is a policy that will evolve over time, and it will change as well as deepen. This outcome seems almost certain in Indonesia. While there is a great need to worry about implementation over the next 24 months, there is also a need to think about the future and to prepare Indonesians to lead it. The following are important areas where the external donors could play a key role:

- Organize a training program in economics and public administration, focused on and built around the specific subject area needs of decentralization (e.g., public finance, budgeting, financial administration, local government).
- Support the development of faculty and curriculum in these areas at several of the Indonesian universities. In time, the technical assistance expertise and the sources of professional staff should be the local universities, but there is much work to do in first developing local expertise in these areas. In addition, such training in the universities

would benefit those who will be elected leaders in the future.

- Support the continued development of training academies for short term certificate courses in policy and public administration, and assist these academies in upgrading their curriculum in areas most closely related to decentralization.
- Assist the government in developing an information system of fiscal and economic data on a regional basis, which will serve as a research source as well as a monitoring and tracking source for evaluating local government performance. This information system would constitute a kind of "census of local government finances".
- Assist the government in setting up a commission on intergovernmental fiscal relations. If the government wanted such an agency, it could be an honest broker of analysis of questions related to intergovernmental finance and could play a role in the performance evaluation and the fine tuning of the fiscal system that must take place in the future. The external donors could assist in setting up such a center, and could assist in providing some supporting staff in the early years.

APPENDIX A: SCHEDULE OF MEETINGS

Friday, May 14

- 1 Dr. Soekarno Wirokartano, Bappenas
- 2 Bappenas staff, Aide Memoire presentation
- 3 Piyush Desai and Jim Stevenson, Senior Advisors, Ministry of Finance

Monday, May 17

- 4 Professor Mohammad Novrizal, Faculty of Law, University of Indonesia
- 5 Professor H. Syahrudin, UNAND in Padang; Professor Lucky Sondakh, UNSRAT in Manado

Tuesday, May 18

- 6 Dr. Bernhard May and Dr. Claudia Buntjen, GTZ

Wednesday, May 19

- 7 Professor Anwar Nasution, Dean and Professor of Economics, Faculty of Economics, University of Indonesia
- 8 Dr. Marwanto Hardjowirjono, Head of Bureau for State Budget Analysis in the Ministry of Finance; Mr. Arlen T. Pakpahan, Head of Bureau, Agency for Financial and Monetary Analysis; and other Ministry of Finance staff

Thursday, May 20

- 9 Mr. Haji Achmad Syarofi, Secretary, Kayu Agung, Palembang (accompanied by Drs. Sanurwin Mahidin and Drs. A. H. Puspowsito of the Universitas Sriwijaya in Palembang)

Friday, May 21

- 10 Terry Myers, Robert Aten, Anthony Chan, David Heeson, and Jon Wegge, USAID
- 11 Prof. Dr. Ir. Herman Haereman, Bappenas
- 12 Dr. Soekarno, Bappenas
- 13 Dr. Sri Mulyani Indrawati, Dr. Anton H. Gunawan, Dr. Robert A. Simanjuntak, Dr. Mohammad Ikhsan, Institute for Economic and Social Research, Faculty of Economics, University of Indonesia

Monday, May 24

- 14 Mr. J. Saruan, Secretary of Bappeda, North Sulawesi

Tuesday, May 25

- 15 Secretariat, North Sulawesi:
 - a Mr. Arsjad Daud, Secretary, North Sulawesi
 - b "Political Officers", North Sulawesi
 - c Mr. J. Th. Suatan, Personnel
 - d Tax officers
- 16 Secretariat, District of Minahasa:
 - a Drs. D. Tanor, Bupati
 - b Mr. R. M. Luntungan, Secretary, Minahasa

- c Mr. Alfons Kainde, Secretary of Bappeda
- d Mrs. Poluangan, Head of the revenue department
- e Other Secretariat staff

Wednesday, May 26

- 17 Secretariat, District of Bitung:
 - a Mr. Is. L. A. Gobel, Secretary, Bitung
 - b Mr. Kapor, Head of the revenue department
 - c Mr. G. A. P. Rorong, Secretary of Bappeda
 - d Mr. Kambay, in Education department in Bitung
 - e Mr. Limpele, Head, Manpower department in Bitung
 - f Mr. Onibala and Mr. Aneta, Personnel
- 18 Mr. Ir. Mohd Mulham Djanas, Manager, Port of Bitung

Thursday, May 27

- 19 Mr. Dirk P. Togas, Head, Education department in North Sulawesi, and staff
- 20 Representatives of the Golkar party in North Sulawesi

APPENDIX B: NOTES FROM MEETINGS

Friday, May 14

1 Dr. Soekarno Wirokartano, Bappenas

The World Bank mission team, led by Sudarshan Gooptu and consisting also of Vinaya Swaroop, Ashoka Mody, and Bert Hofman, met with Dr. Soekarno prior to meeting with a large Bappenas group for the presentation of the Aide Memoire. The main findings were summarized, and Dr. Soekarno raised a few issues:

There is little mention of public administration reform.

Planning and budgeting are easier to accomodate in larger agencies with more personnel.

2 Bappenas staff, Aide Memoire presentation

Sudarshan Gooptu presented the findings of the mission to a group of Bappenas staff, with several advisors to the IMF present as well (Piyush Desai and Jim Stevenson). After the presentation, Dr. Soekarno asked several questions, and then the other participants asked questions or made points: funds may be needed for implementation of decentralization, decentralization will take several years to implement, sequencing is crucial and needs Bank help. Mr. Desai emphasized that only one authority (the Ministry of Finance, or MoF) should have the power of issuing any guarantee on a contingent liability, and Mr. Stevenson said that the final Bank report should "draw out the tension between immediate and longer term changes" (e.g., with the new decentralization laws, there will be over 300 local governments preparing their own budgets, and this opens up the possibility for immense loss of budgetary control by the central government unless mechanisms are put in place to maintain some control). Shan finished by saying that a first draft will be ready by the end of June.

3 Piyush Desai and Jim Stevenson, Senior Advisors, Ministry of Finance

Sudarshan Gooptu and I left the Bank offices to meet with Piyush Desai and Jim Stevenson at the Ministry of Finance. They said that I might visit Jakarta, Bandun, South Sumatra, Bogor, or East Kalimantan, but that I should avoid places like Yogyakarta, Irian Jaya, and Aceh.

Regarding decentralization:

In the personnel area, senior people can be transferred easily to the local governments but lower levels could be more difficult.

The changes, especially the democratization, would take many years.

There are 127 payment and account offices around the country but over 300 district governments; Piyush and Jim would like to have one PAA office in each district, which could form the basis for almost daily updates of budgetary figures and which could give the central government more control over finances.

The new law introduces "administrative decentralization" in which there is no hierarchy in the subnational governments; that is, the center must deal with each of the 300+ district governments (and the 27 provinces, which largely retain their deconcentrated structure), but the provinces do not have any jurisdiction over the districts within their borders. The rationale is a bit unclear, but it may have been to make it difficult for the center to "claw back" authority given to the districts. More broadly, the rationale for decentralization seems largely to have been political, to "give the fruits of democracy to all levels of government".

There is virtually no mention of the villages in the new laws; the district governments will probably prepare their budgets, etc., but these relationships are unclear.

Districts can borrow, especially from regional banks. These banks are largely conduits for

money from the center, are run by local bureaucrats for the benefit of the local government (e.g., they "are not a real bank"), and have just been recapitalized; there is a real concern that local borrowing will be out of control.

There should be a tighter link between regional taxes and service delivery.

Brian Binder (who was instrumental in designing the new system, with the German aid institution GTZ) advocated complete decentralization of all functions to the districts, with no guidelines on budgeting, etc., so that each district government could develop its own system on its own. Jim and Piyus fought this quite hard, and the law now says that the center will provide guidelines. In other words, there is a balance between imposing too much central government control (like the old system) and letting the district governments be completely on their own (as Brian advocated).

There is a real risk that local government bureaucrats will wait until they see the outcome of the elections, then wait until a president is selected, then wait until...In short, not much could happen until well past January 2000, if then.

Monday, May 17

4 *Professor Mohammad Novrizal, Faculty of Law, University of Indonesia*

Roy Bahl and I discussed various aspects of decentralization with Professor Novrizal, as well as the changes implied by the decentralization laws:

There are three principles of local government, in the old and the new law: decentralization, deconcentration, and coadministration. The law (or laws) will become effective one year after the president signs it.

The levels of government in the old system had a hierarchy, but there will be no hierarchy in the new system (although villages must still report to the Level II government).

On election procedures, elected councils will be at the provincial and the district level, selected in elections by the voters. The leaders of the district governments - governor/province, bupati/kabupaten, and mayor/kotomadya - will be selected by the respective elected council, not directly by the voters, and there will be various requirements for candidacy. In the old system, leaders at the district level are appointed by the governor, but they have to be approved by the central government.

On expenditure assignment and budget preparation, budgets will be approved by the elected council, not the central government as in the old system. Also, local governments will now have some flexibility to determine spending levels and composition, unlike the old system, including borrowing (for which there will be few controls); the main way that the central government can influence local policies will be via its allocation of revenues. Further, all deconcentrated functions will be turned over to the district governments. The central government will retain authority over foreign policy, national defense, the justice system, monetary and fiscal policy, and religion; other functions will be turned over to local governments (although some functions will remain deconcentrated at the provincial level).

On the civil service, all central government civil servants in agencies that will be turned over to district governments will be required to become district employees (or will need to find a new central government job). This will require changes in current rules regarding pensions, seniority, fringe benefits, etc., and no such rules exist as of today. Indeed, Professor Novrizal says that local governments are not constrained at all in salaries for civil servants, dismissals, pensions, and the like.

5 *Professor H. Syahrudin, UNAND in Padang; Professor Lucky Sondakh, UNSRAT in Manado*

Roy Bahl and I met with Professors Syahrudin and Sondakh, two professors whom Bob Aten suggested could help us with our work, especially on our visits to the field. (Bob Aten mentioned in passing that Professor Lucky's district - Manado - could be considered a "good" district in terms of administrative capacity; North and South Sulawesi are also possible destinations.)

We asked first about the motivations for decentralization. They said that there were several main factors driving the process:

First, the resource-rich provinces (East Kalimantan, Aceh, Riau, and Irian Jaya) want more revenues from their own resources, the taxes from which now go mainly to the center.

Second, there is a feeling in many provinces that they have been "colonized" for the last thirty years by the center, and "they want to be free" of this.

Third, recent developments in such areas as human rights and democratization are motivating some people.

Fourth, some provinces believe that with decentralization they can more fully develop their own human resources, to an extent that these human resources can replace natural resources as a source of wealth.

At some parts of the central government, there is support for decentralization because there is a feeling that this is one way - maybe the only way - of keeping the nation intact; also, some people argue the economic rationales for decentralization (e.g., greater efficiency), and there are some political rationales for decentralization - this is a policy that seems to be a vote-getter (and Habibie is an advocate).

As for problems with decentralizations, Professor Syahrudin pointed out six (from his paper at an earlier seminar on decentralization):

The quality of human resources in many provinces is low.

Inter-district (and inter-provincial?) inequality is great, in such areas as natural resource distribution.

The movement of goods between districts is very different, which generates different tax revenue implications.

There are some resources that are located right between districts, and it is difficult to determine how to divide these resources (and their tax revenues) between the relevant districts.

The law provides for consolidation of districts, and this could create different "classes" of citizens in the combined district, some poor and some rich.

The role of the province is small and is getting smaller over time, and there is no relationship between the bupati (and mayor?) and the governor of the province.

(Dr. Lucky added that decentralization could create a problem of labor mobility between the rich and the poor regions.) I mentioned that most all of these problems could be dealt with, at least in part, via equalizing transfers, but Dr. Lucky added that the studies needed to implement these transfers are poor or have not been done.

We then talked about the details of work with USAID/PEG: travel, interpreting, discussions with Roy Bahl and me, and attending the various meetings. They were both interested, and went over to the PEG office to meet with Norma Simandjuntak to finalize details.

Later (on Wednesday, May 19), Roy Bahl and I met with Professors Lucky and Syahrudin to discuss in more detail our work. We handed out the documents with the main areas of questions (see Appendix C), and went through them point-by-point. We emphasized that we needed to have meetings with three main types of people:

- political officers (e.g., the bupati)

- the agency heads in charge of spending programs, in the deconcentrated and the decentralized agencies

- the finance/budget officers in the deconcentrated and decentralized departments.

We also told them that we wanted them to write up narratives for the main areas that we had outlined, in which they discuss the current system, the proposed/new system, and their own views on the major issues.

Tuesday, May 18

6 *Dr. Bernhard May and Dr. Claudia Buntjen, GTZ*

Roy Bahl and I met with Dr. May and Dr. Buntjen about various aspects of decentralization. We had been told that GTZ had been intimately involved in the drafting of the laws, and we wanted their perspective on the process.

On the process underlying the two laws, Brian Binder played a prominent role in the development of "The Fiscal Balance between the Central Government and the Regions"; in fact, discussions on this law had been going on in the Ministry of Home Affairs (or MoHA) for some time, and a draft law even existed. GTZ had some participation here but not as much as with the law on "Regional Governance". Here, Mr. Rafiuddin Hamarung, Director General of Regional Development in MoHA was considered the father of decentralization, winning responsibility for the drafting from Dr. Ryass Rasyid (now in MoHA, then head of a public administration institute in Jakarta). Apparently, Dr. Rasyid had been assigned by the President the responsibility of drafting laws on elections, parties, parliament, and decentralization, but the election law dominated the agenda. Dr. Rasyid and Mr. Rafiuddin each sought responsibility for the decentralization law, and Mr. Rafiuddin eventually won out. (There is a budget for drafting laws, and this money can be used for a variety of purposes, including extra salaries, so there is generally a struggle for authority.) Mr. Rafiuddin worked on the laws with a group of 20, then a smaller group of 5-7 people, starting in August or September of 1998. According to Dr. May, there was no real "white paper" on decentralization that was widely circulated within government prior to the drafting of the law, although there may well have existed some kind of "academic paper".

Similarly, there has been little advance preparation for the decentralization. In 1994/95, a pilot program ("District Autonomy Pilot Program", or DAPP) was established, in which a number of local governments were given more responsibilities. As part of this program, there has been some minimal effort to evaluate the ability of local government officials to handle these responsibilities, with the general conclusion that local governments are largely unprepared for any new tasks; that is, responsibilities can be devolved, but local expenditure autonomy must be given, local revenues must be assigned, local administrative capacity must be enhanced, control mechanisms must be put in place, local accountability via democratic elections must be established, and so on.

There does seem to be real electoral reform in the new system. Under the old system, the local head would be selected with heavy involvement of the central government: the Regional People's Representative Assembly (or DPRD) would send five names for the head to the central government,

the center would eliminate two names, and the DPRD would then select one of the remaining candidates (and generally the one who was clearly the favorite of the center). The responsibility of the local head was therefore directed mainly upward, to the central government. In contrast, under the new system the responsibility of the local head is downward, to the DPRD, who will elect the head without approval of the central government.

Overall, Dr. May was somewhat guarded, even a bit pessimistic, about the prospects for a successful decentralization. Although he believes that the administrative capacities of most local government administrators is very limited, he also believes that there should be the ability to transfer central government officials to local governments. He was more worried about the possibility that central government ministries will resist the transfer of their line ministries to provincial and district governments via regulations and mandates, tendencies that are already apparent, because the ministries will lose much influence, resources, salaries, and the like with any transfer ("there are many loopholes, and they are very creative" at this).

The civil service aspects of the transfer have received to date little attention, according to GTZ. Most central government civil servants prefer to stay at the center, rather than be transferred to the province or the district. The intention now is to give no choice in any transfer to the civil servants, and to implement a new civil service act that will essentially merge the now-separate central versus local government tracts of the civil service. There is also discussion about reducing both the number of ministries (from the current 33 to as few as 20) and to the employment within the ministries (by as much as a 30 percent reduction in some ministries). However, there has been little systematic study of these issues to date. As for the "back office support", now given by the center ministries to their deconcentrated counterparts at the local government level, these functions have already been largely shifted to local governments (e.g., procurement, financial management); however, the magnitude of these tasks is now much greater, given the magnitude of the turnover of responsibilities to local governments. For example, local governments already largely prepare their own budgets (although currently these budgets require central government approval), and local governments are also already in charge of maintenance expenditures on capital projects (although with the decentralization they will also be responsible for capital construction).

The decentralization clearly reduces the role and responsibility of provincial governments. President Soeharto wanted to abolish the provinces as autonomous governments, as did President Habibie, and early versions of the laws actually included a provision to this effect. Nevertheless, GTZ worked on versions of the laws that specified two levels of autonomous government, in part because some regions wanted provincial - not district - autonomy, and the law that was passed includes provision for elections at the provincial (as well as the district) level, despite the President's wish. The thinking at the center was apparently that it is easier to deal with 300 "weak" district leaders than 27 "strong" provincial governments; this also explains why there is no hierarchy between district governments and their province - establishing a hierarchy with the province above districts would give too much power to the province. In short, Indonesians are afraid of and hostile to the notion of "federalism". However, although provinces retain some powers in the new system, the part of the laws dealing with expenditure assignment to the provinces is very unclear and was done in a very superficial way. Indeed, many details of the decentralization (e.g., regulations, oversight, technical standards) remain to be determined. (Dr. May believes that the expenditure assignment to the central government is not clearly thought out. These responsibilities originally included defense, foreign affairs, monetary policy, and the judiciary; responsibilities tacked on during the process are fiscal policy and religious affairs. GTZ has made an effort to get the central government to think through

the principles for assignment, working with Dr. Sapta Nirwandar, Assistant Minister for Institutions, but to no avail.)

Wednesday, May 19

7 *Professor Anwar Nasution, Dean and Professor of Economics, Faculty of Economics, University of Indonesia*

Roy Bahl, Professor Lucky, and I met with Professor Nasution to discuss the process of decentralization.

8 *Dr. Marwanto Hardjowirjono, Head of Bureau for State Budget Analysis in the Ministry of Finance; Mr. Arlen T. Pakpahan, Head of Bureau, Agency for Financial and Monetary Analysis; and other Ministry of Finance staff*

Roy Bahl, Professors Lucky and Syahrudin, and I met with the Ministry of Finance, on decentralization issues. (Dr. Noor Fuad, Deputy Minister for Finance and Monetary Affairs in the Ministry of Finance, was supposed to attend but was unable to do so.) The meeting was attended by several others on the staff of Dr. Marwanto. Bert Hofman also joined us during the meeting.

We began by laying out the main questions of our work. Then Dr. Marwanto gave us a document with some summary numbers on the "State Budget" for 1998/1999 and 1999/2000, to illustrate the changes with decentralization. For example:

- regional routine expenditures will be Rp. 19.5 trillion in 1999/2000, and local governments already receive and have the authority to spend these monies; wages and salaries will be Rp. 18.7 trillion, and wages and salaries are determined by the central government;

- regional development expenditures will be Rp. 16.1 trillion in 1999/2000, financed by transfers to the regions;

- local government revenues in the new system will come from revenue sharing (oil, forestry, mining, and fisheries), from specific grant allocation, and from a general grant allocation determined as 25 percent of general domestic revenues (or Rp. 35.6 trillion, equal to 25 percent of Rp. 142.2 trillion in 1999/2000); note that the current grant from the center used to pay wages and salaries (SDO) will be eliminated under the reforms;

- the specific grant allocation will be determined by the Assembly;

- revenue sharing is set by a formula (as specified in the law);

- the formulae for grant distribution have yet to be determined, by a council consisting of people from the Ministry of Finance, the Ministry of Home Affairs, Bappenas, and local governments, and these formulae will attempt some equalization, based on various indicators (e.g., population, area, income).

The description of the process behind the decentralization vaguely suggests that the transfer of expenditure responsibilities to local governments was done first, and the 25 percent assignment of domestic revenues was judged sufficient to cover these expenditure levels: 25 percent of Rp. 142.2 trillion is Rp. 35.6 trillion, which is roughly double regional routine expenditures of Rp. 19.5 trillion. Also, revenue sharing is estimated at about Rp. 6-7 trillion, so that total local government transfers are estimated at roughly Rp. 43 trillion. However, no one at the Ministry knows for certain whether this amount is greater, equal to, or less than the target level of expenditures, either at the aggregate or at the disaggregate level.

Dr. Marwanto and Mr. Pakpahan believe that local governments can absorb their new expenditure responsibilities, although absorption will take some time in some areas. Further, Article 2 of the "Law on Fiscal Balance..." explicitly states that the delegation of authority must be followed by its financing, so that funds should be available at the local government level for provision of the services that are being devolved to there; back office support should still be available at the district level via central government agencies ("co-administration" or "assistance tasks"). However, because of differing capacities - "maybe 10-20 percent of the districts can absorb all their new duties quickly" - a phase-in of the transfer of responsibilities may be the best policy; local governments absorptive capacity is judged to be quite variable, with some very good and some very bad. The decentralization law makes no mention of differential treatment of local governments, but there is a feeling at the central government that the implementation must consider the differences across districts.

Local governments have some revenue instruments of their own. At the provincial level, the main own-source revenues are fees and charges and various taxes on vehicle registration and transfer; at the district level, the main sources are fees and charges and taxes on street lighting, hotels/restaurants, entertainment, advertisements, business registration, and slaughterhouses. Local governments have some but limited autonomy on the determination of rates and bases. No new taxes for local governments are currently under consideration. However, local governments can propose new taxes (e.g., a tax on bird nests), with approval necessary at the central government. Provincial and district governments can borrow for capital projects, with MoHA approval, but no one in the Ministry here knows how extensive such borrowing actually is. It is believed that there will be limitations on local government borrowing in the new system, imposed via ceilings determined by the Director General of Financial Institutions, Mr. Teguh Wiyono.

Overall, Dr. Marwanto believes that the main change with decentralization is not so much on the revenue side (although there are some changes in transfers, as noted above, and although there is some fear that the provinces may have "too much money"). Instead, the main change lies on the spending side - local governments will have more autonomy in determining how to spend their revenues. There is obviously a risk to the central government from a loss of control over local government spending. However, this is "the price of local autonomy", and the line ministries may impose a range of regulations and mandates to maintain some control. The central government will also lose some ability to monitor local governments; there is a group in the Ministry of Finance working on an information system to improve central government access to local government data.

There has been some thought given to decentralization over the years; in fact, the process started about 15 years ago, and something like a "white paper" was (probably) written about 5 years ago. However, nearly all of the implementing regulations have yet to be written, let alone issued, on:

- the balance (or equalization) fund
- deconcentrated finances
- regional finance information systems
- co-administration finances
- the presidential decree for autonomy
- borrowing
- regional financial management and accountability.

Mr. Pakpahan will help coordinate the work on the regulations, and he suggested that analytical and technical input would be helpful on grant formulae, borrowing, regional financial management,

accountability, macroeconomic stabilization implications, and so on.

Thursday, May 20

9 *Mr. Haji Achmad Syarofi, Secretary, Kayu Agung, Palembang (accompanied by Drs. Sanurwin Mahidin and Drs. A. H. Puspowarsito of the Universitas Sriwijaya in Palembang)*

Roy Bahl, Professors Lucky and Syahrudin, and I went to Palembang, about a 45- minute plane ride from Jakarta, where a seminar on decentralization organized by IRIS, USAID, and the University of Indonesia was being held in a local hotel. We arranged to travel by rented car to Kayu Agung, about 90 minutes away, which is the capital of a district in Palembang. There we met with the Secretary of the kabupaten (Mr. Haji Achmad Syarofi) and several other kabupaten officials. Professors Lucky and Syahrudin acted as translators, and we were accompanied by Drs. Sanurwin Mahidin and Drs. A. H. Puspowarsito of the Universitas Sriwijaya in Palembang.

The district has a population of 900,000 people. There are in 14 subdistricts (with 4 subdistricts in the planning stages), 401 villages in rural and urban areas (with 27 villages in the planning stages). The area of the district is 21,000 square kilometers, roughly 65 percent of which is swamp area and 35 percent usable land area.

The organizational structure of governments in the current and new systems looks something like this. In the current system, the central government and its ministries have deconcentrated departments called a kantor wilayah, or kanwil, at the provincial level; in some cases, the kanwil has a sub-branch at the district (or subdistrict) level called a kantor departemen, or kandep. The province has its own planning agency (Bappeda) and various departments (or dinas) under its own control at the provincial level, generally consisting of departments for own revenues (called a dinas pendapatan daerah, or dipenda), as well as dinas for education and culture, health, public works, traffic management, agriculture, livestock, fishery, forestry, plantations, industry, social welfare, labor, and tourism, all of which have central government counterparts in the deconcentrated kanwils; the province may also have branch offices (called cabang dinas) at the district level, although this is apparently not that common. Like provinces, districts have a department in charge of own revenues (again, called a dipenda), and they generally have departments (dinas) for services like health and public works, although the range of these departments depends upon size and location of the district. In the new system, the deconcentrated central government departments at the provincial level will become the responsibility of the province, and those at the district level will be turned over to the district.

Regarding the absorptive capacity of the district government, there was a good bit of confusion on what exactly was going to happen with decentralization; for example, the Secretary said at one point the deconcentrated agencies would remain the burden of the central government and that the civil servants in the provincial deconcentrated agencies could choose whether to join the provincial or the district governments (except in some cases where the civil servant is considered "skilled"), and that salaries would continue to be paid by the central government. There are about 10,000 civil servants in the district government, including 6000 teachers and 2000 nonteachers in the schools. Currently, salaries are paid by the SDO from the central government. The Secretary believes there will be no problem in paying the salaries of any new civil servants, but there could be a problem in funding other routine expenditures. For example, some new departments will be created here (e.g., forestry) that do not currently exist, and funds must be found for these departments, especially for

maintenance, transportation, utilities, electricity, papers, water, phones, and the like; also support services for these new departments must be funded. He estimates that the extra burden of these various routine expenditures could be as much as Rp. 15 billion, although this was mainly a guess. In this regard, the 1999/2000 budget of the district will be Rp. 111.0 billion, with Rp. 77.9 billion in routine expenditures and Rp. 33.1 billion in development expenditures; salaries total Rp. 67.2 billion.

The civil service implications of the decentralization are largely unknown at present, since no regulations have been written or issued. Again, the Secretary does not believe that salaries will be a major issue: he believes that the funds should be there and that the civil service rankings (which determine salaries) will not be much affected. However, there is some concern about guarantees (or lack thereof) for certain positions, especially supervisory ones in departments that will be created or moved to district control. Also, in the case of the Secretary, his current ranking is 2B; under the new system, he believes that his position will require a higher ranking of 1B (the same as a provincial-level Secretary), so he may not actually be "qualified" for his position in the new system. More generally, with new required rankings, there may not be sufficient numbers of qualified civil servants for the various positions.

As for other things that will change with the decentralization, the Secretary and his staff believe that the quality (and probably the quantity) of human resources will improve because the district will have more authority to select its employees (although they admit that they do not know the new civil service rules). Also, they believe that district revenues will increase because grant revenues will increase generally and because there will be more civil servants with (they believe) the accompanying transfers for salaries (although they do not know any numbers and they have not done any calculations here). The Secretary and his staff are not convinced that they will have much more spending autonomy in the new system, given the many and strict controls that the central government and its ministries are able to impose on the district. They do not anticipate doing any borrowing (and there is no borrowing at present) - there is "no need". (A budget summary indicates that revenues in 1999/2000 will total Rp. 111.0 billion, consisting of previous year revenues of Rp. 4.3 billion, own revenues of Rp. 3.2 billion, and transfers from the central government of Rp. 103.5 billion (of which Rp. 69.0 billion are SDO).)

It is noteworthy that the Secretary believes that in the new system the Secretary will be stronger than the bupati. Although there is functionally no real change, the Secretary believes that bupati will be controlled more by political currents, giving more authority to the Secretary. Currently, the Secretary reports to the bupati, and the bupati to the governor of the province; in the new system, the Secretary will still report to the bupati, but the bupati will report the locally elected council.

Friday, May 21

10 Terry Myers, Robert Aten, Anthony Chan, David Heeson, and Jon Wegge, USAID.

Roy Bahl and I presented some preliminary findings from our work to USAID at a breakfast meeting.

The presentation focused upon three main areas:

1. General Comments on the Decentralization
 - A good idea that is long overdue
 - An emphasis on expenditure, not revenue, decentralization
 - A number of problems/issues in the process
2. Problems/Issues in the Process
 - Aggregate numbers do not add up
 - Local governments may have difficulties absorbing new duties

- Civil service implications have not been examined
- Local accountability is improved
- The ability of the central government to lead and to monitor is unclear
- There are no productive local government revenue sources
- There are questions about whether a "hard budget constraint" exists
- There is no transition plan
- There are no implementing regulations.

3. What Can Donors Do To Help?

- Get the "white paper" back into the process
- Provide assistance on analytical issues
- Perform case studies at the district level
- Help in writing regulations
- Assist in the transition plan
- Create local government capacity via training programs.

11 *Prof. Dr. Ir. Herman Haereman, Bappenas*

Roy Bahl, Professors Lucky and Syahrudin, and I met with Dr. Haereman. He indicated that as far back as 1974 there was a draft paper (in the five-year plan) on decentralization. Then in the third five-year plan Bappenas began developing institutional capacity at the local level. All this suggests that there has been some thought given to decentralization in the past, even if there was little dissemination of these papers.

In the current system, local governments have two main types of budgets: the routine budget (including SDO), and the development budget; in the new system, SDO and block grants will be combined via the general grant allocation, which must be used for (among other things) civil service salaries. Also, in the current system, there are central government employees seconded to the province or district (and paid by the center) and central government employees stationed in central government offices at the province or district level; in the new system, there will be no seconded employees, and these must be absorbed by the respective local government. However, all local government civil servants must meet certain grade or rank requirements; if these grades are not met, then the local government can ask the center for assistance. This suggests that the central government will (or should) schedule the decentralization in phases, depending upon the absorptive capacity of the local governments, and Bappenas is working on the appropriate scheduling. In fact, Bappenas has a rating of provincial governments, based upon over 80 variables, including their human resource capacity, education level, income, natural resource endowments, government capacity. This rating indicates that only 3 of the 27 provinces meet appropriate standards at present. There is no rating of district governments. Dr. Haereman estimates that only 20 percent of the districts can handle their new responsibilities.

In the new system, local governments will get revenues from the general allocation (the 25 percent fund), revenue sharing, and specific allocations. Dr. Haereman says that "everyone is screaming for more" funds, and that a Bappenas study indicates that only 10 percent of the districts will have enough funds to be self-sufficient. He believes that this suggests that government at all levels needs to be downsized and that some central government civil servants will need to be transferred to lower levels.

12. *Dr. Soekarno, Bappenas*

Immediately following this meeting, the same group met with Dr. Soekarno. He indicated that his

division in Bappenas (which deals with fiscal and monetary affairs and planning coordination) has not been closely involved in the decentralization discussions, although he would like this to change in the future. For example, he has not examined whether the 25 percent general allocation fund will be too much or too little for local governments; his guess at present is that the amount is not sufficient, but the central government did not specify a greater percentage of domestic revenues because it is difficult to get these funds back after they have already been given. At the central government level, his studies suggest that the national budget over the next 5 to 10 years does not look good, and that central government borrowing will "skyrocket" (including an estimated Rp. 34 trillion for interest costs in one year). Instead of a greater percentage for the general allocation, Dr. Soekarno would like, say, the property tax devolved to local governments. He also said that the precise role of Bappenas in the new system is largely unknown at present.

Of the three main revenue transfers to local governments in the new system (revenue sharing, the general allocation fund, and specific allocations), development grants from specific allocations will continue to come from Bappenas. However, some specific grant functions could be turned over to local governments (e.g., responsibility for maintenance expenditures). The distribution formulae for the transfers have yet to be determined. A grants commission will be established to determine the formulae, and will consist of central government officials, local government officials, and academics.

Dr. Soekarno believes that there has been some thought given to the decentralization, mainly in the Ministry of Finance, but that there has been little dissemination of the findings. Overall, he believes that things have been done in a "rush", and any calls for a slowdown in the process have been ignored in the attempt by the Assembly to produce a product. In particular, expenditure assignment (especially at the provinces) has been done quickly and without careful thought, and local government officials are largely uncertain about what decentralization will really mean for them. Also, given limited local government capacity, the sequencing of decentralization is a crucial issue. However, Dr. Soekarno believes that there is no going back at this point, and that accountability at the local level will definitely increase.

13. *Dr. Sri Mulyani Indrawati, Dr. Anton H. Gunawan, Dr. Robert A. Simanjuntak, Dr. Mohammad Ikhsan, Institute for Economic and Social Research, Faculty of Economics, University of Indonesia*

Roy Bahl and I went to the University of Indonesia to discuss decentralization issues with Dr. Sri Mulyani and her colleagues. Then at 2:00pm, Roy gave a seminar on rules for decentralization, followed by a discussion of these principles in the Indonesian context led somewhat loosely by me. There were about 40 people in attendance.

Monday, May 24

14. *Mr. J. Saruan, Secretary of Bappeda, North Sulawesi*

Professor Lucky and I met with Mr. Saruan (who was taking a course from Professor Lucky). Bappeda is the provincial planning agency, responsible for planning and spending development (capital) programs. The office reports to the governor, not to the central government. There are no central government deconcentrated agencies at the provincial level that work on development programs.

Mr. Saruan said that many of the details of the decentralization laws have not been worked out, and he has not seen any regulations, even in draft form; however, he said that this is normal, and

implementation is planned for a 2-year transition period. In fact, Bappeda here has in the past 5 years already implemented some of the features of the new laws. For example, INPRES funds to the provinces have been channeled directly to district governments since 1994, and 20 programs funded by these specific grants have been given to the district governments, including programs for roads, health, drinking water, primary schools, agriculture, and marketplace development. A former Minister of Home Affairs, Mr. Roubini (?), started this process as early as 1987, giving more authority to the districts by having the funds go directly to the districts rather than through the kakanwil (the head of a central government office in the province). Overall, Mr. Saruan estimates that roughly 60 percent of the programs have been effectively decentralized since 1994.

In the same vein, Mr. Saruan has been preparing his staff for greater responsibilities by encouraging the staff to improve the education attainment. Currently, there are 100 people in Bappeda; 60 percent have the equivalent of a B.A. or B.S. (or 4-year college) degree, 13 have an M.A./M.S. degree, and another 15 are working on an M.A./M.S.

The funds for Bappeda come mainly (80 percent) from the central government, with only 20 percent from provincial own-source revenues. More precisely, in 1999/2000, total income is projected to be Rp. 148.7 billion, of which Rp. 19.2 billion will be own-source revenues and Rp. 129.4 billion will be central government transfers, mainly specific and general Inpres allocations and SDO grants; the province will have no revenues from borrowing (and Mr. Saruan says that Bappeda cannot borrow). Development expenditures will be Rp. 86.2 billion and routine expenditures will be Rp. 62.5 billion. Bappeda does not collect any revenues itself, but does control revenues allocated for development planning.

The current budget process for Bappeda is a "bottom-up" procedure. Beginning in August, Bappeda collects information from the various lower-level dinas (or departments) on what projects the officials there wish to undertake and how much these projects will cost; this information is examined by the regional coordinating committee on development planning. From this information, Bappeda writes a first draft of a provincial development plan, which is presented in October (with those of other provinces) to the national coordinating committee on development planning. Bappeda receives notice on the approved plan early the next year, and gets a final budget in April, for the next fiscal year. Overall, Mr. Saruan believes that he has substantial autonomy in determining the development plan, even though final approval comes from the central government, and he does not believe that the decentralization will enhance (or lessen) this autonomy. The main change is that final approval for the budget will come from the provincial-level assembly, rather than from the central government; however, the formulation of the budget will remain a bottom-up process.

Nevertheless, Mr. Saruan believes the decentralization will give the province "more room to maneuver" and "less intervention from above". For example, suppose that in the current system the Department of Public Works gets Rp. 150 billion, with another Rp. 50 billion allocated for and tied to specific programs; in the new system, the Department may get, say, Rp. 200 billion with no strings attached on its use.

In addition, Mr. Saruan believes that total revenues for the province in the new system will be substantially greater than in the current system. The current (1998/1999) budget for Bappeda is about Rp. 100 billion, 90 percent of which comes from the center; in the new system, Mr. Saruan predicts that the budget will be as much as Rp. 1 trillion because the current budgets of the deconcentrated agencies will now go to the province. Of course, the spending responsibilities of

these agencies will also be turned over to the province.

The civil service implications of decentralization are very uncertain at present. Mr. Saruan predicts that central and local government employees will be placed on the same track in the new system, which will require that the salaries continue to be paid by the central government; he is aware of the elimination of SDO, but believes that maintaining the "unity" of the civil service, as well as allowing for the mobility of civil servants across provinces and districts, will require continued central government control of salaries. In the current system, only the governor can decide whom to fire among provincial employees; Mr. Saruan can decide whom to hire. A major change with decentralization is that many current central government employees will report to the governor, rather than to the central government ministries in Jakarta. Also, Mr. Saruan estimates that as many as 500,000 civil servants (out of about 1.5 million civil servants in 330 departments) will lose their jobs, and that many central government employees will be forced to move to the provinces or the districts; for example, there may be 1500 additional employees in the provincial government in North Sulawesi, of which roughly 25 would come to Bappeda.

Tuesday, May 25

15. *Secretariat, North Sulawesi:*
 - a. *Mr. Arsjad Daud, Secretary, North Sulawesi*
 - b. *"Political Officers", North Sulawesi*
 - c. *Mr. J. Th. Suatan, Personnel*
 - d. *Tax officers*

Professor Lucky and I went to the Governor's office at 9:00am, where we had meetings scheduled with various provincial departments. Mr. Arsjad Daud, the Secretary of the province, began by describing the steps that the province has undertaken in preparation for the decentralization: workshops on the legal aspects of the new laws, on institutional and personnel issues, and on finance and revenues matters. These workshops are planned in two stages over the planned two years of the implementation (e.g., 7 May 1999 to 7 May 2000, and 7 May 2000 to 7 May 2001).

The characteristics of the province of North Sulawesi include:

- the population is 2.7 million
- there are 7 districts (4 kabupaten and 3 kotamadyas), 93 subdistricts, and 1527 villages
- the Gini coefficient is 0.26, the Human Development Index places the province in the top 3 among provinces, life expectancy is 64 years, the literacy rate and the fertility rate place the province in the top 2 among provinces
- per capita (annual) income is Rp. 2 million (or about US\$ 250 at the current exchange rate of US\$ 1 = Rp. 8000), and this has fallen in real terms by about 8 percent the last year
- the main sources of income are agriculture, mining, and forestry.

After this initial discussion with the full group of about 25 people, we met with smaller groups. The first group of officials (at 9:30am) was the "political officers". The election procedure goes something like this, as specified in the laws on political parties, on general elections, and on the composition of the assembly. On June 7, there will be separate votes to elect representatives to the central government, the provincial government, and the district government assemblies. Individuals will vote on a different slate of candidates at each level, as determined by the political parties, with

individuals allowed to vote for a different party at each of the three levels. Individuals vote on the party, not the candidate, although the names of the candidates for each party (and the priority of these candidates) is known in principle by the voters. There will be (approximate) proportional representation, as determined by the percentage of the vote garnered by the party, with the executive committee of the party determining who actually sits in the assembly. In this determination, the party is supposed to go by the priority listing; for example, if the election results determine that a party gets 2 representatives, then the first 2 names on the party's candidate list will be selected by the party. However, the party can remove candidates - and representatives - at its own discretion, with no input from the central government or the elected head (e.g., the governor of the province, the bupati (or regent) of the kabupaten, or the walikota (or mayor) of the kotamadya). Parties must meet several criteria to be placed on the ballot (e.g., the party must have branches with membership of at least 50 people in at least 14 (or $1/2 + 1$) provinces, the party must have branches in at least 3/4 of all districts in a province); there are also candidate qualifications (e.g., at least a high school education, at least 21 years of age, the ability to read and speak Indonesian).

In North Sulawesi, the provincial assembly will consist of 45 representatives, 5 from the military and 40 elected by the voters. Each party can put up to 80 people (or double the number of elected representatives) on its candidate list. If a party gets, say, 30 percent of the provincial vote, then the party will be able to seat $.30 \times 40$, or 12 representatives in the assembly, selected from the first 7 candidates on its list. For the national assembly, North Sulawesi will receive 7 seats, although the process by which these 7 seats will be allocated among the parties is not yet determined. Results for the national assembly should be known by July 3-July 12; for the provincial assembly, by June 27-July 2; and for the district assembly, by June 20-June 26. The respective assembly will elect the head of the government by majority rule. At the provincial level, the provincial assembly has authority in three areas: passage of legislation, election/control of the governor, and supervision of the budget.

All in all, the officials believe that there will be considerably more accountability and transparency than under the old system, especially given the authority of the assembly over the head.

At 10:30am, we met with Mr. J. Th. Suatan, in the personnel department of the province, who controls (some aspects of) civil service of provincial employees in the decentralized departments, not those in deconcentrated departments. In North Sulawesi, there are no provincially-controlled agencies at the district level, but Mr. Suatan maintains personnel records for all civil servants in autonomous departments at the district (and the province) level; he does not keep records for those civil servants in deconcentrated central government departments. At present, Mr. Suatan says that there are 45,800 civil servants in autonomous departments of the province (5000) and the districts (40,800) in North Sulawesi. There are another 35,000 employees in deconcentrated agencies throughout the province. With decentralization, most of the 35,000 employees in the deconcentrated agencies would become provincial or district civil servants. Mr. Suatan sees "no problem" in absorbing these employees, including the provision of any back-office support now coming from Jakarta. In fact, his paperwork might well be simplified because at present he must maintain personnel records for the 40,800 district employees and in the new system many of these would report only to the district.

At present, the salaries of the civil servants are paid by SDO. Salaries (basic salary only) start at Rp. 300,000 per month and increase to Rp. 800,000 per month; there are also allowances and incentives. Minimum qualifications include such things as good health and a high school education. Training programs are available, offered in Jakarta as well as elsewhere. The governor can fire

only the non-skilled among the provincial civil servants (or those not in "professional" areas), which suggests that any spending autonomy is not completely matched with personnel autonomy.

At 11:30am, we met with several tax officers, who provided a summary budget for 1999/2000 and an estimated budget for 2000/2001, based on current information on the amount of revenues/expenditures in the deconcentrated agencies that will be devolved to the province. (It is interesting that the 1999/2000 numbers are similar, but not identical, to the numbers from Mr. Saruan, the Secretary of Bappeda. Mr. Saruan's total budget number was Rp. 148.7 billion; the numbers today are Rp. 155.1 billion.) According to the current budget for 1999/2000, revenues and expenditures are Rp. 155.1 billion. The department estimates that revenues will increase to Rp. 1,413.9 billion in 2000/2001, given their estimates of their share of the general allocation fund, of specific grants, of revenue sharing, and of salaries and development budgets of deconcentrated agencies. Of course, there will also be greater expenditure responsibilities, and the department estimates that expenditures will increase from Rp. 155.1 billion in 1999/2000 to Rp. 1,119.1 billion in the next year. On balance, then the estimates are that revenues will exceed expenditures by Rp. 294.8 billion, although this is recognized as only a rough estimate.

The tax people say that Law 18/1997 specifies 9 new tax instruments that are available to provinces, in partial compensation for the elimination of some other taxes. These include taxes on airports, seaports, trade, and communication. They say that the province can choose tax rates, up to some limit, with the approval of the assembly, although this power has not been used to date. They also say that they do not have enough money, and are trying to get new taxes assigned to the province, including the tax on land and buildings. There is no borrowing to date, in part because the province can only borrow up to Rp. 250 million (a limit imposed by the regional development bank). In the future, the province will consider borrowing, depending upon the terms of the loan.

16. *Secretariat, District of Minahasa:*

- a. *Drs. D. Tanor, Bupati*
- b. *Mr. R. M. Luntungan, Secretary, Minahasa*
- c. *Mr. Alfons Kainde, Secretary of Bappeda*
- d. *Mrs. Poluungan, Head of the revenue department*
- e. *Other Secretariat staff*

Professor Lucky and I drove to Tondano for a meeting at the kabupaten (Minahasa) centered there, where we met at around 2:00pm with Drs. D. Tanor, the bupati of Minahasa; Mr. R. M. Luntungan, the Secretary of the Minahasa district government; Mr. Alfons Kainde, the Secretary of Bappeda; Mrs. Poluungan, the Head of the revenue department; and several others in the Secretariat.

The characteristics of the Minahasa district include:

the population is 700,000, and the area of the district is 400,000 hectares

Minahasa is one of 7 districts in the province, and contains 30 subdistricts and 523 villages
per capita (annual) income is Rp. 2.6 million (or about US\$ 325 at the current exchange rate
of US\$ 1 = Rp. 8000), and this has been roughly constant in real terms over the last
year

70 percent of the labor force is in agriculture.

Regarding the electoral process, there are several differences between the old and the current system, which contribute some to greater local accountability. The most important is that accountability is bottom-up, or to the assembly, rather than top-down, or to the governor and the

President, as in the old system - this is a "real change". Nevertheless, Mr. Tanor (the bupati) is quite firm in saying that the autonomy of the bupati is largely unchanged in the new electoral system. In part, this stems from a lack of own local revenues. Mr. Tanor admits that spending autonomy is likely to be greater in the new system, but he believes that there will be relatively little real change in autonomy even on spending, given a wide range of legal restrictions and regulations on the use of block grants: there will be "decentralization in management" but there will be "no decentralization in finance", especially due to the restrictions on the use of grant monies, and "you let my head be free but you keep hold of my tail". Another concern is the quality of individuals elected to the assembly.

Regarding the budget, the financial staff believes that district revenues will decline by Rp. 2.4 billion (relative to a total budget in 1998/1999 of Rp. 127.4 billion or an estimated total budget in 1999/2000 of Rp. 154.3 billion). The reason for the decline is that the district has a large amount of mining royalties (relative to other districts), and these revenues must be shared with the 7 districts in the province. However, they do not have firm estimates of the total budget. Of total revenues in 1998/1999, Rp. 6.5 billion (or 5.1 percent) come from own-sources; the corresponding prediction for 1999/2000 is Rp. 6.7 billion (or 4.3 percent). According the Law 18/1997, the major local taxes are:

- tax on hotels and restaurants
- tax on recreation/entertainment
- tax on advertisements
- tax on road lighting
- tax on water service
- tax on surface mining.

The tax people say that, prior to Law 18/1997, the district could not change the base or the rate of the taxes, but it could change the "intensity" of collections, essentially the amount of compliance. Under the new law, the district now can change the tax rates (up to some limit), with the approval of the Assembly. No new taxes are being considered at present, although the district would like the authority to administer the tax on land and buildings. The district plans on borrowing Rp. 400 million from the World Bank in 1999/2000, to be used for various public services (e.g., water, marketplace) and to be repaid in 5 years with an initial grace period; the Secretary says that this required the approval of the Assembly and the Ministry of Finance.

Regarding the absorption of the personnel in the deconcentrated agencies, there are currently 12,000 employees in the district civil service, 6000 in deconcentrated agencies, and another 6000 teachers. Minahasa was a participant in the District Autonomy Pilot Program (DAPP), during which the transfer of 9 (deconcentrated) departments with 500 employees to the district occurred: manpower, manufacturing, trade, social, cooperatives, mining, health, rural development, and registration. The results of the pilot were threefold. First, there was no problem in absorbing the employees. Second, there was no problem in providing most of the basic services of the departments. Third, however, there were financial problems because only funds for routine expenditures (salaries) were transferred to the district, and no funds for development expenditures were transferred. The Secretary believes that this last problem could also arise in the decentralization, if sufficient funds (aside from salary support) are not provided. There seemed little concern about funding salaries, and also little concern about the lack of information on implementing regulations.

Wednesday, May 26

17. *Secretariat, District of Bitung:*

- a. *Mr. Is. L. A. Gobel, Secretary, Bitung*
- b. *Mr. Kapor, Head of the revenue department*
- c. *Mr. G. A. P. Rorong, Secretary of Bappeda*
- d. *Mr. Kambay, in Education department in Bitung*
- e. *Mr. Limpele, Head, Manpower department in Bitung*
- f. *Mr. Onibala and Mr. Aneta, Personnel*

Professor Lucky and I met with various people in the district of Bitung, beginning at 9:00am. The Secretary of the kotamadya, Mr. Is. L. A. Gobel, said that the political situation is quiet at present. He needed to leave soon to meet with a UNDP mission on training election officials and staff. Before leaving, he gave some details of the district:

the area of the kotamadya is 30,400 hectares

the population is 118,000

there are 4 sub-districts (north, south, east, and central)

per capita income is Rp. 3 million, which has fallen in the last year

the main sources of income are industry, agriculture, fishery

the district has "good" rankings in social indicators

there is a national park

Bitung is a major port ("Gate to the Pacific").

Mr. Gobel (and his staff) also said that the accountability of the district government should increase with the planned decentralization because the central government will no longer interfere as much in local decisions. The citizens have "high expectations" that those elected will be accountable to them, although he cautioned that "it remains to be seen". Also, on the relationship between the Secretary and the mayor (or the walikota), Mr. Gobel said that the role of the Secretary is both more important and more risky: the Secretary is a "professional" and this role will become more important now - for the Secretary to survive, "he must be professional" and meet various requirements (e.g., minimum rank and education) - but there also are more hazards in his job because politics will play a bigger role in the future. Currently, the mayor proposes a Secretary candidate to the governor and the governor makes the appointment, and only the governor can fire the Secretary (on the basis of a recommendation from the Mayor); under the new system, the Mayor will propose a candidate to the district council and the council will approve (or not), and the Mayor can fire the Secretary with the approval of the Council.

Regarding the revenues of the kotamadya, the revenue officer, Mr. Kapor, presented a budget summary showing that total revenues in 1998/1999 are Rp. 28.6 billion, of which Rp. 3.8 billion (or 13.3 percent) are own-source revenues; in 1999/2000, the corresponding estimates are Rp. 36.5 billion and Rp. 3.2 billion (or 8.8 percent). The main own sources of revenues are from regional taxes, regional retributions, profits from government enterprises, and other sources; regional taxes are imposed on advertisements, hotels and restaurants, recreation, road lighting, surface mining, and ground water. The administration of these taxes is currently determined by Law 18/1997, and the staff people say that a new law must be passed to make Law 18/1997 consistent with the two decentralization laws; however, the regulations have yet to be issued, so there is some confusion about the current revenue autonomy of the district (e.g., district control of tax rates, new taxes). The district can borrow under the new decentralization system: any borrowing must be approved by the Assembly, and, if foreign borrowing, it must also be approved by the central government. The district has borrowed twice since 1992/1993, both times from the World Bank at 11.5 percent: Rp.

875 million, for roads in 1992/1993, and Rp. 2.5 billion, for a terminal station in 1996/1997. If the district was unable to repay the loan, the staff people say that the central government would assume the obligation, but the central government would also deduct any amounts paid by it from the grant allocation to the district. Mr. Kapor does not know whether revenues will increase or decrease with decentralization, in large part because the formulae for grant allocations have not been announced. However, he is somewhat pessimistic on revenues, stating that he does not believe that funds for salaries will be sufficient and that revenue sharing between the central and local governments has not been carefully thought out; on the first point, he says that all funds for salaries should be taken out of the general allocation fund and given to local governments before any remaining funds are distributed by formula, in order to ensure that salaries are paid.

We then met with Mr. G. A. P. Rorong, the Secretary of Bappeda. Bappeda's budget in 1999/2000 is Rp. 16.7 billion, with a staff of 24 people, and the budget is determined by a bottom-up process. Development proposals start at the village, then go to the subdistrict, and finally to the district; at the district, Bappeda selects and refines the proposals, establishing a priority ranking and working with the revenue people, before sending a development plan up. Mr. Rorong says that decentralization will have little effect on this part of the process. The main effect will come with the approval of the budget: in the old system final approval came from the governor, while in the new system approval comes from the Assembly. Because of this, he believes that the district will in fact have more autonomy ("more discretion") in the new system. He also believes that Bappeda can absorb any new staff who will come from the deconcentrated agencies. Under the old (or current) system, Bappeda played mainly a coordinating role with the deconcentrated departments; under the new system, any development functions of these departments will go through Bappeda directly. Mr. Rorong believes that the main problems here will be: in improving human resource quality to the (estimated) 50 new staff out of the 1000 civil servants in the deconcentrated agencies who will come to Bappeda, and in providing support services ("we do not have the funds"). Nevertheless, Mr. Rorong believes that Bappeda will be able to manage the changes.

We then met with two staff in deconcentrated agencies, Mr. Kambay (in Education) and Mr. Limpele (in Manpower, who is the local head, or kakandep, of the deconcentrated agency at the district level, or kandep). Currently, both are responsible to their respective line minister, although their agencies sometimes coordinate with the district counterparts where their responsibilities overlap. With decentralization, both Education and Manpower will be turned over to the district. Mr. Limpele says that "it is easy to turn over an agency to a district". However, Mr. Limpele and Mr. Kambay are very concerned about what will happen, in several dimensions. They are worried about their careers: the changes are not good for career advancement because a district is too small. They worry also because "we are specialists" whose skills may not be appreciated or understood in a local civil service. Issues like seniority (e.g., who will be the head of a deconcentrated department merged with a district counterpart agency - "That is my worry"), promotion, and transfer in the new system are very hazy at present; these will be determined by the district (not the central) government personnel people and their evaluations, and, again, the district may not apply the same standards as currently. Mr. Limpele and Kambay are also concerned that funds for salaries will not be sufficient. In the new laws, the money is supposed to follow the functions assigned to local governments, but it is not clear to them that the appropriate amounts of money will actually follow. There is no district counterpart agency in Manpower, so that regulations need to be written to establish a district department and this has not been done. Both Mr. Limpele and Mr. Kambay worry that current support provided to their departments from the line ministries in Jakarta will not be provided, or even funded, in the new system.

We then met with Mr. Onibala and Mr. Aneta in Personnel. At present, there are 1872 civil servants in the 11 district dinas (including 214 in the Secretariat), with a salary budget of about Rp. 1 billion. In the deconcentrated agencies (e.g., education, manpower, health, information, trade, port authority, land institutes, family planning), there are about 3000 employees with a base salary that ranges from Rp. 200,000 per month to Rp. 800,000 per month. Mr. Onibala and Mr. Aneta do not know where the funds for salaries will come from in the decentralized system. The district will be responsible for the salaries, but they believe that the central government must transfer the necessary funds and they do not know if this will happen. Also, current staffing in the district is low, by about 700 people; they say that these additional people will be needed to handle the deconcentrated agencies, and they do not know where the funds will come from. With decentralization, the number of district dinas will increase from 11 to 21, adding new ones in fishing, livestock, mining, forestry, land institutes, industry, manpower, education and culture, cooperatives, and trade.

18. *Mr. Ir. Mohd Mulham Djanas, Manager, Port of Bitung*

Professor Lucky and I met with the manager of the port, Mr. Ir. Mohd Mulham Djanas. He said that the port currently contributes to the revenues of the district via its shares of the tax on land and buildings (Rp. 125 million) and of the VAT (Rp. 300 million). Possible new taxes from the port include district-imposed fees on the entry and exit of ships, on handling of cement, and on handling of asphalt. The port was built by the central government in the 1950s, and Mr. Djanas' company (Pelindo) pays a fee to the central government for the right to manage and maintain this and 16 other ports in Indonesia. In 1997, the total profits from all 17 ports were Rp. 19 billion.

Thursday, May 27

19. *Mr. Dirk P. Togas, Head, Education department in North Sulawesi, and staff*

Professor Lucky and I met with Mr. Togas, the head (or *kakanwil*) of the (soon-to-be) deconcentrated education department (or *kanwil*) of the province of North Sulawesi, as well as his staff.

The department currently employs 4685 administrative staff and 36,365 teachers (23,500 in primary schools, 7604 in secondary schools, 3013 in general high schools, 1308 in vocational schools, and 940 in religious schools). There are 3917 schools (2961 primary schools, 541 secondary schools, 190 general high schools, 57 vocational schools, and 168 religious schools), and there are 538,514 students (341,004 in primary schools, 108,000 in secondary schools, 47,765 in general high schools, 26,054 in vocational schools, and 15,691 in religious schools). The budget is Rp. 246.6 billion, or Rp. 135.6 for the routine budget and Rp. 111.0 billion for the development budget.

Mr. Togas believes that decentralization has been considered carefully at the central government and that the extra competition between provinces that will result will be "good". However, he also says that too many of the details of decentralization have yet to be determined or clarified. Also, he worries about the ability of the local governments to take over all the responsibilities of education. In particular:

Currently, his department reports to the Minister of Education in Jakarta. In the new system, he will report to the provincial government, although the specific person in authority is unknown at present.

Currently, his department gets extensive help from Jakarta on curriculum design, book selection, construction, teaching assistance, promotion criteria, and general

administration. In the new system, these services will be provided by the province, and he is not confident that the province can perform well. One response of the line ministry is likely to impose an extensive array of regulations that will be uniform across the country ("This is a unitary state after all").

Educators are "specialists", and Mr. Togas is concerned that their skills will not be fully valued by the province.

Currently, his personnel are central government civil servants. In the new system, they will become provincial government civil servants, and many issues there have yet to be determined (e.g., salaries, promotion, transfers).

Currently, salaries are paid by the central government. In the new system, salaries will be paid by the provincial government, and Mr. Togas is uncertain whether sufficient funds will be available.

Because of these concerns, Mr. Togas believes that the decentralization should be introduced in sequence, not all at once. He also says that the quality of the personnel needs to be improved.

20. *Representatives of the Golkar party in North Sulawesi*

Professor Lucky and I met with representatives of the Golkar party in North Sulawesi, who explained some details of the election process. Seats in the provincial assembly will be determined by a "proportional plus" system. There are an estimated 1.7 million voters in North Sulawesi, and 40 elected seats in the assembly (plus 5 non-elected seats for the military). (In the district of Minahasa, there will be 36 elected and 4 non-elected representatives in the district assembly, and in the district of Bitung there will be 22+3 representatives.) Dividing the number of voters by the number of elected representatives gives about 40,000, so that each 40,000 in votes for a party will entitle the party to 1 representative in the Assembly. Also, North Sulawesi will have 7 seats in the national assembly, or one from each district. However, the procedure for determining these 7 representatives is not fixed. One possibility is to have representative determined in each district by the party that wins a plurality in that district; another possibility is to use the proportional representation as determined by province-wide (and not the district-side vote). Regardless, the actual representatives - at all three levels will ultimately be selected by the winning party. On balance, the Golkar representatives believe that there will be much more accountability because the selection comes from the grass-roots, not from the central government.

APPENDIX C: ISSUES/QUESTIONS ON DECENTRALIZATION

Issue: Present System versus New System

Electoral System/Accountability:

1. How does the electoral system operate, in terms of issues like the selection of candidates, the platforms of these candidates, the voting process, and so on?
2. How is chief executive of the local government selected?
3. How is the chief local officer selected?
4. Are local government officials accountable to local citizens or to the central government?

Government Structure:

5. What is the relationship between the central, provincial, and district governments (decentralization)?
6. What is the relationship between the central, provincial, and district-level government agencies (deconcentration)? In particular, how will the remaining deconcentrated agencies operate under the New System, and which central government ministry will administer the remaining deconcentrated agencies in the New System?
7. How does the central government monitor the activities of local governments?
8. How many local governments (and of what type) are there?
9. What are the provisions for consolidation of governments?
10. What is the role of village governments?

Expenditure Assignment and Expenditures:

11. What is the assignment of expenditure responsibilities to the central, provincial, and district (and village) governments?
12. What discretion/autonomy do local governments have in determining the level/composition of local spending?
13. Are there central government controls (in the form of minimum standards or mandates) on local government actions?
14. Do local governments undertake capital expenditures? Maintenance of capital projects?
15. What are the civil service regulations, in areas like compensation, seniority, pensions, transferability, and dismissal, and are these regulations uniform across local governments?
16. What is the capacity of local government officials to administer the expenditure programs? Do these capacities differ by sector? How are these capacities measured?

Revenue Assignment and Revenues:

17. What tax instruments are assigned to local governments?
18. What discretion do local governments have in determining rates and bases, of existing and new taxes?
19. Is there revenue sharing between the central and local governments?
20. Can local governments borrow? From whom? Reporting to central government? Limitations?
21. What forms of intergovernmental transfers are used? Formula?
22. What is the administrative capacity of local governments in tax administration?

Financial Reporting:

23. How, and by whom, are budget accounts maintained?
24. Do local governments have supervision in their financial recordkeeping?

25. Who monitors/audits the budgets of local governments, and what are the penalties for irregularities?
26. Who prepares the budget?
27. Who approves the budget?
28. What is the administrative capacity of local governments in financial reporting?

APPENDIX D: SYAHRUDDIN AND WERRY DARIA TAIFUR

APPENDIX E: LUCKY SONDAKH